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C O N F I D E N T I A L SECTION 01 OF 04 CARACAS 000108

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ENERGY FOR CDAY AND ALOCKWOOD
NSC FOR JCARDENAS AND JSHRIER

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TAGS: [EPET](#) [ENRG](#) [EINV](#) [ECON](#) [VE](#)
SUBJECT: PDVSA WAKES UP TO ITS PRODUCTION PROBLEM

REF: A. 2007 CARACAS 183
[1](#)B. 2006 CARACAS 02297
[1](#)C. 2006 CARACAS 01238

Classified By: Acting Economic Counselor Shawn E. Flatt for Reason 1.4
(D)

[1](#)1. (C) SUMMARY: PDVSA's volume committee, which normally works on production planning, is aggressively pressuring joint venture partners and service companies to increase crude oil production. In order to facilitate production increases, the BRV is attempting to streamline administrative procedures including a waiver on drilling permits. Private sector oil companies and service companies still face significant delays in payment and administrative hurdles. We do not believe that PDVSA will be able to significantly raise production without ceding operational control to the private sector. This would inevitably involve reversing political direction. It is not clear at this point if the BRV and PDVSA are willing to jettison ideology in order to gain additional production.

PDVSA'S SINS FIND IT OUT

[1](#)2. (C) Embassy contacts report that PDVSA's volume committee, which normally works on production planning, has been aggressively pressuring joint venture partners and service companies to increase crude oil production. According to OPEC's January 2008 figures, Venezuela's production declined from an average of 2.539 million barrels per day in 2006 to 2.391 million barrels in 2007. Most alarmingly, there was a sharp decline in average daily production in the last two months of 2007.

[1](#)3. (C) Contacts also report that the committee has been charged with streamlining administrative procedures in order to increase production. Harvest President and Chief Executive Officer James Edmiston, Harvest Vinccler Vice

President Mauricio di Girolamo and Harvest Vinccler Operations Manager Karl Nesselrode (strictly protect all throughout) told Petroleum Attache (Petatt) on January 24 that PDVSA stated on January 21 that drilling permits were waived until December 31, 2008. According to di Girolamo, drilling and workover operations that appear in a joint venture's business plan do not require permits. The joint ventures are free to drill when they wish to do so.

13. (C) Major international oil companies (IOCs) have also reported that PDVSA is pressing them to increase production in their projects. Wes Lohac, Chevron's new Latin America Managing Director, (strictly protect throughout) told Econcons and Petatt on January 25 that PDVSA has approached his company about increasing production at Petropiar (the former Hamaca strategic association) and Petroboscan. Lohac said PDVSA has also asked Chevron if it could reduce costs at the two joint ventures at the same time. Lohac noted that it is difficult to imagine how the joint ventures could increase production at the same time they were investing lower amounts in the two projects. BP Venezuela President Joe Perez (strictly protect throughout) also stated on January 23 that PDVSA officials have approached his company about increasing production at Petromonagas (the former Cerro Negro strategic association). Perez said BP was limited in terms of the resources that it could put in Petromonagas.

14. (C) Service companies are also being pressured to increase production as quickly as possible. Schlumberger marketing director for oil services Paolo Cense (strictly protect throughout) told Petatt on January 24 that his company has seen a "frenzy of requests" for assistance this

CARACAS 00000108 002 OF 004

month. Cense also stated that PDVSA has made a number of promises to Schlumberger regarding improvements to the operational environment.

15. (C) Baker Hughes Latin America Vice President for Sales Edgar Pelaez and Latin America Operations Manager Bernardo Burr (strictly protect both throughout) told the Ambassador on January 25 that PDVSA moved up a major public tender in order to increase production this year. According to Pelaez, PDVSA requested bids on a two year rigless production improvement (workovers) five to seven months ago. The project covered 1,040 wells and the goal was to increase production by 200,000 barrels per day. PDVSA recently told service companies that the project was now a one year project with a completion date of December 2008 and that they needed to modify their bids accordingly. When the companies protested that they could not meet the original January 29 deadline for bids given the new terms, PDVSA officials told them that the deadline would remain the same. Pelaez stated PDVSA officials called a special meeting of major service companies to press upon them the importance of participating in the tender. Pelaez noted that PDVSA's inflexibility with the deadline limited the service companies' options.

THE ONE WHO SOWS SPARINGLY WILL ALSO REAP SPARINGLY

16. (C) We attribute the production decline to three factors: a significant decrease in investment, the BRV's tendency to base petroleum policy on political rather than commercial considerations, and PDVSA's byzantine administrative procedures (Reftel). Harvest executives noted that production at the Petrodelta joint venture has declined from a high of 32,000 barrels per day to 12,000 barrels per day. The executives attributed the decline to the fact that almost nothing has been invested in the fields since 2006, when discussions began to migrate the operating service agreements to joint ventures. Nesselrode noted that many of the wells are suffering from severe corrosion problems due to the lack of maintenance. In many cases, equipment will have to be replaced since it is beyond the point of salvage.

¶7. (C) Private sector partners in the joint ventures have little reason to invest more in fields. The joint ventures are separate legal entities that are supposed to stand on their own. In addition, companies are still waiting to be reimbursed for funds that they advanced for operating expenses (opex). The companies are also waiting to see their portion of the fields' profits. The Harvest executives noted they have only been reimbursed for opex through October 2007. Harvest has not received its share of profits since April 2006.

¶8. (C) PDVSA may attempt to attract additional private sector investment by giving up equity in two of the current Faja joint ventures. Perez stated PDVSA officials told him they believe PDVSA's equity stakes in Petromonagas (83.34%) and Petrozuata (100%) are too high. He also believes PDVSA may try to accelerate development of the most promising Faja blocks. According to Perez, the Carabobo block in the eastern portion of the Faja is the pick of the four major blocks. He noted the Chinese (Sinovensa) and Petromonagas have individual Carabobo blocks and added the parties in Carabobo have the resources and abilities to develop or further exploit its blocks. Perez hinted BP may reexamine its position on increasing investment in Venezuela if it received a sufficiently lucrative offer in the Faja.

¶9. (C) As noted in Reftel A, political considerations have frequently produced PDVSA policies that have little or no commercial sense. Pelaez and Burr noted PDVSA recently sent

CARACAS 00000108 003 OF 004

two of its drilling rigs to Ecuador and charged the Ecuadorians a day rate that was 60 to 70% below current international rates. They stated PDVSA was basically providing Ecuador with a USD 35,000 per day subsidy per rig. In addition, the BRV has starved PDVSA of investment funding in order to fund its ambitious social programs. Finally, President Chavez has frequently turned to PDVSA when other BRV ministries have failed to produce results. For example, earlier this month, Chavez announced the creation of a new PDVSA affiliate, PDVAL, which would operate a nation-wide food distribution network.

MAYBE ITS TIME FOR THE GOLDEN RULE: PEOPLE LIKE TO BE PAID

¶10. (C) Administrative constraints and general incompetence also impose significant impediments to increased production (Reftels B & C). Edmiston stated he believes Harvest could raise production at Petrodelta's original fields as well as the three additional fields it received during the joint venture migration to 70 to 100,000 barrels per day if Harvest did not have to comply with PDVSA procedures. Nesselrode observed that Petrodelta can only secure additional drilling rigs via PDVSA subsidiary CVP. Neither Petrodelta nor Harvest as a partner in the joint venture can secure rigs on their own. As a result, Harvest is being penalized by PDVSA's inability to secure rigs on the international markets.

¶11. (C) According to Nesselrode, PDVSA is currently seeking 22 drilling rigs. He stated PDVSA has been unable to secure additional rigs because rig companies either do not have any rigs available or they are unwilling to send them to Venezuela. He added that rigs are currently stacked in Canada due to a slowdown in the gas sector. Edmiston disagreed slightly with Nesselrode and opined that PDVSA could get all of the rigs that it wanted if it were willing to post a bond for the full value of the rigs with a U.S. bank.

¶12. (C) CVP's general incompetence may also lead to labor problems for Harvest at Petrodelta. According to the Harvest executives, 96% of their employees migrated to the Petrodelta joint venture. As a result of the migration, CVP was supposed to begin paying the employees on January 1. CVP told Harvest that it was unable to pay the employees due to

problems transferring them to the CVP system. Harvest paid the employees and invoiced CVP for the amount. However, it warned CVP that it was only going to pay the employees one time. The executives said they were waiting to see if the employees would be paid at the end of the month.

¶13. (C) Service companies also suffer from BRV and PDVSA policies. Pelaez told the Ambassador that Baker Hughes is still making money in Venezuela but that it is becoming more difficult to do so. According to Pelaez, his company has three basic challenges. First, Venezuela's fixed exchange rate combined with its high inflation rate means that Baker Hughes' service prices in U.S. dollars are not keeping up. In addition, PDVSA has delayed bids and in some cases canceled contracts in order to squeeze as much as it can out of old contracts. When new bids are delayed, service companies continue providing services under the terms of the expired contracts. Finally, PDVSA has been changing the dollar/bolivar mix on its payment terms. PDVSA subsidiary Maraven has been attempting to pay all of its obligations with bolivars. Pelaez stated the problem with bolivar payments is that there is no efficient mechanism for changing them to dollars. CADIVI, the BRV entity that handles foreign exchange transactions, will only grant foreign exchange for forward transactions. In other words, a party has to request foreign exchange prior to an event. Given the nature of oil

CARACAS 00000108 004 OF 004

industry, service companies are regularly required to provide parts and services on short notice. Since CADIVI will not grant foreign exchange for past transactions, the service companies are stuck with bolivars.

GETTING OUT OF PRODUCTION PURGATORY

¶14. (C) Embassy contacts believe that PDVSA's current efforts to increase production will only result in a slight increase in production at best. Pelaez best summed the situation up when he stated "PDVSA can't mandate reality". Nesselrode stated PDVSA officials told him that Petrodelta must meet its 2008 volume targets and that PDVSA would accept no excuses. He stated there was no way that Petrodelta could reach the target given the administrative impediments that he faces. Edmiston opined that the only way PDVSA would be able to increase production significantly is to grant the private sector oil companies operational control of the joint ventures. He stated only the private sector companies have the capacity to plan and implement complex production programs. Cense basically told Petatt the same thing. He stated service companies are capable of making recommendations to PDVSA but they are not designed to create production plans for fields.

¶15. (C) COMMENT: We concur with Edmiston and Cense. We do not believe that at present PDVSA has the managerial depth or the administrative flexibility to design and implement complex production improvement plans. As Pelaez and Burr noted, PDVSA's master production plan accurately reflects what it needs to do. Unfortunately, PDVSA has basically had the same production plan for the last 10 years. It has repeatedly proven that it is incapable of implementing its own plan.

¶16. (C) Edmiston told Petatt that a Venezuelan friend is fond of saying that Venezuelans are inept at planning but are highly effective at dealing with a crisis. There is no doubt that a lack of planning at the regional and field levels has played a major role in creating PDVSA's production dilemma. The question now is whether the BRV and PDVSA believe the dilemma is enough of a crisis to warrant a huge injection of capital and new pragmatic policies toward the private sector.

END COMMENT

DUDDY